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MCLE ETHICS SELF-STUDY

Joint Defense of Suits Brought Against Public Entities and Their Employers: Are Conflicts of Interest Manufactured or Real?

By *Manuela Albuquerque, Esq.**

Introduction

By now, it is not subject to reasonable dispute that public lawyers are governed by general ethical considerations applicable to other lawyers, although the application of ethical constraints to public lawyers must take account of the role that public lawyers play and the public interest.[1] Moreover, even the most cautious city attorney or county counsel would concede that the issue of who they represent has been well established: the city or county is the client, not the myriad subordinate entities and officials that collectively embody the client when those officials and entities act in their official capacities. (E.g. *Ward v. Superior Court* (1977) 70 Cal.App.3d 23; State Bar Rule of Professional Conduct 3-600)[2]

On rare occasions, there may be more than one client, for example when a quasi-independent entity and the governing body are involved in litigation against one another.[3] This article does not, however, concern the conflicts of interests which may arise in such litigation between the governing body and a quasi-independent constituent body when they are adverse parties in litigation. Instead, it focuses on whether, and to what extent, a public lawyer may run afoul of the State Bar Rules of Professional Conduct regulating conflicts of interest when that lawyer is engaged in the joint representation of a public entity and a public employee or official when both are defendants and thus on the same side in a civil action.

In order to analyze this issue it is important first to become familiar with the statutory duties of public entities with respect to the defense and indemnification of public employees and officials. The California Government Code sets out a comprehensive statutory scheme for determining the rights of public employees to a defense and indemnification from their employing entities with respect to suits filed against them arising out of the course and scope of their employment.[4] Thus, this article next discusses this statutory scheme.

The Scope and Nature of the Public Entity's Duty to Defend and Indemnify Employees

The critical duty to provide a defense is imposed upon the public entity by Government Code Section 995, which provides in pertinent part:

"Except as otherwise provided in Sections 995.2 and 995.4, upon request of an employee

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or former employee, a public entity shall provide for the defense of any civil action or proceeding brought against him, in his official or individual capacity or both, on account of an act or omission in the scope of his employment as an employee of the public entity. For the purposes of this part, a cross-action, counterclaim or cross-complaint against an employee or former employee shall be deemed to be a civil action or proceeding brought against him."

This provision has been held to apply to actions pursuant to 42 U.S.C. § 1983.[5]

Under Government Code § 995.2, this basic duty to defend is qualified by three additional limitations:

"(a) A public entity may refuse to provide for the defense of a civil action or proceeding brought against an employee or former employee if the public entity determines any of the following:
(1) The act or omission was not within the scope of his or her employment.
(2) He or she acted or failed to act because of actual fraud, corruption, or actual malice.
(3) The defense of the action or proceeding by the public entity would create a specific conflict of interest between the public entity and the employee or former employee. For the purposes of this section, "specific conflict of interest" means a conflict of interest or an adverse or pecuniary interest, as specified by statute or by a rule or regulation of the public entity."

Thus, the statue already contemplates that a "specific conflict of interest" could result in the separate representation of the entity and the employee.

The Government Code goes on to explain that the public entity may provide for the employee's defense by "its own attorney or by employing other counsel for this purpose or by purchasing insurance which requires that the insurer provide the defense".[6] Finally, Government Code § 825 provides that where the employee has timely requested the defense, the act or omission arose out of the course and scope of the public employment and the employee has cooperated in good faith in the defense, the entity must pay any judgment arising from the suit or any settlement or compromise "to which the entity has agreed". (Emphasis added.)[7] These sections have been read to give the public entity and not the employee the right to control the employee's defense.[8]

The statutory scheme also permits the entity to assume the defense of the employee under a reservation of rights as to whether the act or omission arose out of the course and scope of employment and to pay the judgment or settlement "only if it is established that the injury arose out of an act or omission occurring in the scope of his or her employment as an employee of the public entity."[9] If the governing body makes certain findings, the public entity may indemnify the employee against an award of punitive damages as well.[10]

Before turning to the specific obligations imposed on lawyers to avoid a conflict of interest and their application to particular circumstances which confront a public lawyer, this article discusses certain threshold principles which have been enunciated in cases dealing with public attorneys' conflicts of interest. In other words, conflict of interest issues concerning public sector attorneys must be analyzed bearing in mind several important caveats articulated by the courts.

Special Considerations Applicable to Public Sector Attorneys

The courts have articulated special considerations which are applicable to evaluating claims of conflict of interest in the public sector and which suggest that these issues merit a nuanced and careful approach. In *In Re Lee G.*,[11] the Court of Appeal pointed out that the conflict of interest rules "developed in the private sector...do not squarely fit the realities of the public attorney's practice."[12] Similarly, another Court of Appeal has observed that the financial incentives are not the same in the public sector as those in the private sector and thus, there is less concern about conflicts of interest.[13] Because disqualification of public counsel can result in increased expenditures for legal representation and thus substantially heightened demands on an "already severely strained tax base," disqualification should be imposed with caution.[14] Another factor militating against disqualification is the "potential deprivation of the client of the services of an attorney highly skilled in a particular area of the law...."[14]

Accordingly, the statutory scheme for the defense and indemnification of public employees and the special considerations applicable to analyzing conflict of interest issues in the public sector must be kept in mind when evaluating the application of the State Bar's Rules of Professional Conduct to the joint defense of public employees and entities in civil actions.

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State Bar Rule of Professional Conduct 3-310 Concerning Conflicts of Interest

The key provision of the State Bar Rules of Professional Conduct governing conflicts of interest in the context of representing two clients who may be adverse to one another is Rule of Professional Conduct 3-310.[16] The operative language is contained in 3-310 (C). That subsection provides in pertinent part as follows:

(C) A member shall not, without the informed written consent of each client:
(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or
(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or
(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is

adverse to the client in the first matter.

A cursory review of the language in Rule 3-310 (C), which requires the employee's written consent to joint representation when the clients' claims "potentially conflict," may suggest that the Rule is at odds with the statutory scheme for the defense and indemnification of public employees, since the Government Code authorizes the entity to choose the means of defense, including its own lawyer,[17] and to deny a defense only when there is a "specific conflict of interest between the public entity and the employee …."[18] Nevertheless, the only cases which have considered the issue have found no conflict and have found no reason for the courts to usurp the legislative prerogative in determining the rights of public employees to defense and indemnification based upon imagined conflicts.

Interestingly, these cases have arisen in the context of a private firm - not the one chosen by the city or county to represent the employee- that claims that it is entitled to defend the employee at public expense because of a claimed conflict by the counsel representing the entity. It is no small irony that the firm constituting the "independent counsel" purporting to represent the interests of the individual employee has itself a pecuniary interest (and thus arguably a conflict of interest) in arguing that the entity and the employee have a conflict of interest, since this argument is designed to ensure that the entity pays the firm to defend the suit even though it has the effect of requiring the entity to pay twice for the defense of the same action.

Cases Applying Rule 3-310 in the Public Sector in the Context of the Defense of Public Employees

There are three reported cases considering the application of Rule 3-310 to claims of public employees that they are entitled to independent counsel. All three flatly rejected the argument. In the first, *Laws v. County of San Diego*,[19] employees of a county sheriff 's department sought a writ of mandate to compel the county to provide them independent counsel in connection with the defense of a police misconduct suit asserting a violation of civil rights. The suit sought both compensatory and punitive damages.

The county's letter advising the defendant deputy sheriffs of their right to a defense and indemnification stated that the sheriffs would be personally liable for punitive damages if any were awarded, and that the county would defend against the entire suit but advised them that if they wished to retain independent counsel in light of the claim for punitive damages, the county would cooperate with any independent counsel they retained. The deputies then retained independent counsel to review the letter. He advised the county that the limitations contained in the county's letter constituted a reservation of rights which triggered to a conflict of interest which would not be waived by the deputy sheriffs. He asserted, therefore, that they were entitled to retain the firm as independent counsel at county expense.

The claimed conflict in *Laws v. County of San Diego* was premised on *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.*[20]. In that case an insurance company attorney who defended the insured under a reservation of right as to coverage was found to have a conflict of interest in representing both the insured and the insurance company where the defense of the action could have been conducted in a way which buttressed the insurance company's claim that the suit was not covered under the policy, and worked to the detriment of the insured who would then be denied indemnification. The essence of the *Cumis* court's holding was that, under those facts, it was not possible for the counsel undertaking the joint representation of the insurer and the insured to advance the interests of the insurance company in the litigation, without compromising the interests of the insured, as a result of the reservation of rights. The coverage issue turned on whether the acts were willful and were grounded on breach of contract, rather than on tort. The latter would result in coverage the former would not.

The court in *Laws v. County of San Diego* rejected the claims of the deputy sheriffs that the counsel selected by the county had a conflict of interest. It did so on several grounds. In general, the court found the insurance context not analogous to the statutory scheme for defending and indemnifying public employees. First, it noted that, unlike the insurer in the *Cumis* case, the county had not reserved its rights on the issue of whether the conduct arose out of the course and scope of employment.[21] Second, the county has the discretionary power to approve the payment of a claim of punitive damages unlike an insurer for whom it would be against public policy.[22] Third, the court noted that a post *Cumis* case had held that the mere existence of a punitive damages claim does not create a *Cumis* conflict.[23]

Finally and perhaps most importantly the court observed:

> [C]hanges in the manner in which defenses in civil actions are provided for public employees have the potential for enormous fiscal impact on state and local governments. The relationships of public employee groups and their respective employers are also matters of considerable importance to the functioning of government in this state. These are not problems well suited to ad hoc judicial solution. We therefore decline to attempt modification of the existing legislative scheme. Our analysis of existing law convinces us Laws's claims are unfounded.[24]

The second case to consider whether a conflict of interest existed between an employee and entity in the context of the joint defense of a civil action, *Stewart v. City of Pismo Beach*,[25] likewise rejected the claim. There, the defendant police officer Stewart resigned during the pendency of the civil action, and gave an interview to the plaintiffs' investigator making various incriminating statements about himself and the city in exchange for the plaintiffs' assurance that he would be dismissed from the action. Stewart then boldly claimed that there was a conflict of interest with the city and that he was therefore entitled to independent counsel in the civil action. The city denied Stewart a defense on the grounds of a specific conflict of interest and his failure to cooperate in his defense. The Court upheld both determinations, noting that "here Stewart is essentially asking the City to pay for a lawyer to help Stewart (and the plaintiffs) dig the City's grave in the federal action. We think this is exactly the result that [Government Code § 995.2 (C)] was intended to avoid."[26]

The final appellate case to address the issue of whether the employee has a right to demand independent counsel is a Ninth Circuit case, DeGrassi v. City of Glendora.[27] In rejecting the employee's argument, the Ninth Circuit appeared to consider the matter largely disposed of by *Laws v. County of San Diego*. In *DeGrassi*, a city council member had repeatedly made charges that the owner of a landmark building was a child molester, despite the advice of counsel that she not do so. The owner of the building then filed a defamation action against the council member and the city agreed to assume her defense subject to the condition that she cooperate in her defense, and that the city control the litigation and approve any settlement. The council member refused to accede to representation on these terms and instead retained her own attorney and sought reimbursement from the city for her legal expenses. The court upheld the trial court's rejection of her claim for reimbursement, finding that the city's action in conditioning the defense was completely consistent with the statutory scheme for the defense and indemnification of public employees.[28]

Interestingly, the court specifically rejected the notion that the employee can claim independent counsel on the grounds of a conflict of interest. It concluded that Government Code § 996.2 gave only the city the right to decline a defense on the grounds that there was a specific conflict of interest between it and the employee. If the city provided a defense, however, the employee had no basis to decline it and demand independent counsel on the grounds that there was a conflict of interest.[29] The court found that the council member's reliance on Government Code § 996.4 was misplaced, since that section only provides a right to seek reimbursement when the entity fails to provide a defense.

Although these cases seem to resolve conflict of interest issues with sole reference to the Government Code statutory scheme, a recent federal district court in the Central District of California in a case involving the City of Riverside appeared to completely ignore the *DeGrassi and Laws* cases and ordered disqualification of counsel on the grounds that the entity and employee's interests "potentially conflicted" and that the employee's continued representation was therefor impermissible without the employee's informed written consent pursuant to Rule 3-310.[30] Thus, a closer look at the relationship between the statutory scheme for public employee defense and indemnification and the Rules of Professional Conduct appears to be in order to determine whether the Central District Court's decision broad ruling in the Riverside case is warranted by Rule 3-310 and the case law. This article concludes that it is not.

The Judicial and Legislative Power Relating to Conflicts of Interests

Conceptually, both the judicial and legislative branches jointly undertake the regulation of the legal profession. "In the field of attorney-client conduct, we recognize that the judiciary and the legislature are in some sense partners in regulation."[31] In *Santa Clara County Counsel Attorneys Association v. Woodside*, the California Supreme Court held that the Meyers- Milias- Brown Act (MMBA), authorizing public lawyers to form unions and to sue their employer/clients for violations of the MMBA, did not violate the constitutional separation of powers doctrine by authorizing violations of ethical duties imposed on lawyers to avoid conflicts of interest under Rule 3-310 and the common law duty of loyalty. In reaching that conclusion, the Court noted that "We have never held a statute of general application, which does not affect the traditional areas of attorney admission, disbarment and discipline, unconstitutional."[32]

If Rule 3-310 were to be read to conflict with and supercede the Government Code, the court would in effect be holding the statutory scheme unconstitutional on separation of powers grounds. In the *Santa Clara* case, the California Supreme Court rejected claims that the Rules and common law duty of loyalty precluded suits by lawyers to enforce MMBA rights, thus revealing its careful and nuanced approach to identifying conflicts. Thus, the question remains whether and when a conflict of interest arises under Rule 3-310 in cases involving the joint defense of public employees and the employing by entities.

Rule 3-310 and Joint Representation

Rule 3-310 (C) requires informed written consent solely when a lawyer accepts representation of two clients whose interests "potentially conflict". The prior discussion has established that the cases and statutes establish some clear legal principles when an employee is named as a defendant. The employee's defense is paid for by the entity, controlled by the entity and any ensuing damages, other than punitive damages are paid by the entity. The mere fact that punitive damages are claimed does not by itself create a conflict of interest. The employee has a duty to fully cooperate in the defense and thus to disclose all relevant facts to the entity, a duty presumably required irrespective of the existence of the suit, and this duty of cooperation is not consistent with conspiring with the plaintiff to make the entity and not the individual liable. These duties apply irrespective of which lawyer undertakes the defense. If there are adverse facts in the record regarding disciplinary action, those facts are adverse to the pecuniary interest of both the entity and the employee since the entity's liability is derivative. Both have an interest in excluding any discipline as inadmissible subsequent remedial action.

Although the legal basis for holding an individual rather than an employee liable may be different under various causes of action, the ultimate interests of the entity are in avoiding or limiting liability either direct or indirect. Thus, the entity's interests are no different with respect to the defense of the employee when it is named directly. In short, the entity and the individual do not have divergent interests merely because the individual insists on asserting, like the council member in the *DeGrassi* case, that she did no wrong. The entity has the right to insist upon controlling the defense and agreeing to a settlement so as not to tilt at legal windmills at great cost. For all these reasons, under normal circumstances, the employee and entity will not have cognizable interests in the civil action which "potentially conflict" within the meaning of Rule 3-310 (C).

On the other hand, if a defense is conducted under a reservation of rights, it would appear to be a conflict of interest for an attorney to conduct a joint defense if the entity intends to argue in the civil action that the employees' conduct did not arise out of the course and scope of employment. The courts in both the *Laws* and *DeGrassi* cases pointed out that the entities in those cases were not reserving their rights to argue that the acts or omissions in the civil actions did not arise out of the course and scope of the employment and thus, the defense of the action could not adversely affect the employee's right to indemnification. Those cases may well have been resolved differently had the very right to indemnification been at issue.

In addition, where the entity is investigating imposing disciplinary action based on the conduct at issue in the civil action, it would appear to be a conflict of interest for the same firm or office (city attorney or county counsel) to both advise the entity on discipline adversely to the employee and simultaneously represents the employee in the civil action based upon the same conduct.

Conclusion

In conclusion, the reported cases appear to reject the principle that the joint defense of employees and entities per se poses conflicts of interest which require the employee's informed written consent to the entity's choice of counsel. Nonetheless, in this writer's opinion, if an entity requires reservation of rights on the question of whether the act or omission arose out of the course and scope of employment or pursues simultaneous disciplinary action against the employee based upon conduct at issue in the civil action, the entity would be required to appoint separate counsel for the employee.

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Endnotes

1 See, e.g., *People ex. rel. Deukmejian v. Brown* (1981) 29 Cal. 3d 150, 157. Accord, *Santa Clara County Counsel Attorneys Association v. Woodside* (1994) 7 Cal. 4th 525, 548.)
2 Rule 3-600.
3 See, e.g., *Civil Service Commission v. Superior Court* (1984) 163 Cal. App. 3d 70, 75-78.)
4 Government Code Sections 825 *et. seq.*
5 *Williams v. Horvath* (1976) 16 Cal. 3d 834, 843.)
6 Government Code Section 996.
7 Section 825.
8 *DeGrassi v. City of Glendora* (9th Cir. 2000) 636 F. 3d 636, 642.)
9 Government Code Section 825(a).
10 Government Code Section 825(b). See text of section in note 2, supra.
11 (1991) 1 Cal. App. 4th 17, 34.
12 See also, *People v. Christian* (1996) 41 Cal. App. 4th 986, 999.
13 *Castro v. Los Angeles County Board of Supervisors* (1991) 232 Cal. App. 3d 1432, 1441.
14 In *Re Lee G., supra*, 1 Cal. App. 4th 28.
15 Id.
16 Rule 3-310. Avoiding the Representation of Adverse Interests [Prof. Conduct, Rule 3-310 (West LawDesk CD-ROM with amendments received through December 1, 1999)]
17 Government Code Section 996.
18 Government Code Section 995.2(a)(3).
19 (1990) 219 Cal. App. 3d 189.
20 (1984) 162 Cal. App. 3d 358.
21 *Laws v. County of San Diego, supra*, 219 Cal. App. 3d at 199-200.
22 Id.
23 Id, citing *Foremost Insurance Co. v. Wilks* (1988) 206 Cal. App. 3d 251, 261-262.
24 *Laws v. County of San Diego, supra*, 219 Cal. App. 3d at 201.
25 (1995) 35 Cal. App. 4th 1600.
26 Id. at 1606.
27 (9th Cir. 1999) 207 F. 2d 636, 642-643.
28 *DeGrassi v. City of Glendora, supra*, 207 F. 3d at 642-643.
29 Id. at 642-643.
30 *Miller v. City of Riverside*, United States District Court for the Central District of California, No ED Cv 99-0176 RT (RZx). The City of Riverside is seeking Ninth Circuit certification of an interlocutory appeal.
31 *Santa Clara County Counsel Attorneys Association v. Woodside* (1994) 7 Cal. 4th 525, 543.
32 Id.

MCLE SELF-ASSESSMENT TEST

1. The public lawyer's client is each individual public official.

   ❏ True ❏ False

2. A public lawyer represents the entity.

   ❏ True ❏ False

3. A public lawyer can never have any more than one client.

   ❏ True ❏ False

4. The State Bar Rules of Professional conduct do not apply to public lawyers.

   ❏ True ❏ False

5. What is ethical depends only upon one's own sense of right.

   ❏ True ❏ False

6. There are cases and ethical statues and rules, which govern whether a public lawyer is acting within ethical constraints.

   ❏ True ❏ False

7. State Bar Rule of Professional Conduct 3-310 applies to public lawyers.

   ❏ True ❏ False

8. The public lawyer could have a conflict of interest if the governing body and a quasi-independent entity end up suing one another.

   ❏ True ❏ False

9. There is absolutely no difference in how ethical rules are applied to private lawyers and public lawyers.

   ❏ True ❏ False

10. The Government Code authorizes a public employee to choose his/her own counsel to be paid at public expense whenever the employee is sued.

    ❏ True ❏ False

11. The entity controls the defense of the employee when the employee acts within the course and scope of the employment and the entity has agreed to undertake the employee's defense.

    ❏ True ❏ False

12. The entity is required to provide a defense to employees in any civil action that arises out of the course and scope of employment.

    ❏ True ❏ False

13. The public entity's offer of a defense to an employee is provided without any conditions.

    ❏ True ❏ False

14. The public entity's defense is provided to the employee only if the employee did nothing wrong.

    ❏ True ❏ False

15. The public entity's defense of an employee can be withdrawn if the employee fails to cooperate in the defense.

    ❏ True ❏ False

16. The employee can choose to cooperate with the plaintiff to impose liability on the entity and will have the right to obtain independent counsel at public expense.

    ❏ True ❏ False

17. Any joint representation of an employee and entity always presents a conflict of interest for the public lawyer and requires the employee's informed written consent to the representation.

    ❏ True ❏ False

18. The only reported appellate cases have rejected public employees' claims that they are entitled to independent counsel.

    ❏ True ❏ False

19. If the public entity undertakes a defense of a public employee but reserves the right to deny indemnification at a later date, on the grounds that the representation was not within the course and scope of the employment, the public lawyer may have a conflict of interest in representing both the employee and entity in the same action if the defense of the action will involve arguing that the employee did not act within the course and scope of employment.

    ❏ True ❏ False

20. If the employee is being disciplined for acts or omissions, which are at issue in a civil action, it is likely to be considered a conflict of interest for the same law office to undertake the employee and entity's defense in the civil action while at the same time advising the entity with regard to the disciplinary matter.

    ❏ True ❏ False

Proposition 37: The Latest Salvo in the Ballot War Against Fiscal Discretion for Local Governments

By Michael G. Colantuono, Esq.*

Introduction

The November 7, 2000 ballot will include the latest initiative effort to curtail the fiscal power of state and local governments. Entitled the "Two-Thirds Vote Preservation Act of 2000," the measure is co-sponsored by the California Chamber of Commerce, the California Manufacturers & Technology Association and the California Taxpayers Association. If adopted, Proposition 37 would redefine certain regulatory fees as "taxes," subject to Proposition 13's requirement[1] that new State taxes obtain approval of two-thirds of each chamber of the Legislature and to Proposition 218's requirement[2] that new local taxes obtain majority (for general taxes) or two-thirds (for special taxes) voter approval.

The critical provision of the measure reads as follows:

> "For purposes of [Section 3 of Article XIII A], 'state taxes' do not include an 'assessment' or 'fee' as defined in Article XIII D, sections 2(b) and 2(e), real property development fees, or regulatory fees that do not exceed the reasonable cost of regulating the activity for which the fee is charged. Provided, however, compulsory fees enacted after July 1, 1999 to monitor, study or mitigate the social or economic effects of an activity, and which impose no significant regulatory obligation on the fee payor's activity other than the payment of the fee, and regulatory fees that exceed the reasonable cost of regulating the activity for which the fee is charged, shall be deemed state taxes subject to the two-thirds vote requirement of this section. Monies recoverable in damages, remedial expenses, or penalties arising from a specific event shall not be deemed taxes or fees.
>
> "This section shall not apply to 1) any fee that was authorized by law prior to July 1, 1999, 2) any increase in such fee attributable to inflation, or 3) any increase in such fee attributable to increased workload, provided such increased workload is not the result of expansion of the class of activity or activities to which the fee applied prior to July 1, 1999."[3]

A substantially identical provision is to be added to Article XIII C, the tax provision of Proposition 218.[4]

The expressed intent of the proposal is to overrule the California Supreme Court's decision in *Sinclair Paint Co. v. State Board of Equalization*.[5] Accordingly, analysis of the potential impact of Proposition 37 begins with review of *Sinclair Paint*.

The Sinclair Paint Decision

The Legislature adopted, by simple majorities in each house, the Childhood Lead Poisoning Prevention Act of 1991.[6] The Act provided for evaluation, screening, and medical services for children exposed to lead poisoning. The Act's programs were funded by fees levied on manufacturers and other persons presently or previously engaged in the stream of commerce of lead or products containing lead, or who are otherwise responsible for identifiable sources of lead, which have or do significantly contribute to environmental lead contamination. Those able to show that their industry did not contribute to environmental lead contamination, or that their products did not "result in quantifiably persistent environmental lead contamination" are exempt from the fee.[7]

Sinclair Paint attacked the fee, alleging that it was an invalid tax, and obtained summary judgment from the Sacramento Superior Court, and an affirmance from the Third District Court of Appeal. The Supreme Court unanimously upheld the measure as imposing a valid regulatory fee pursuant to the police power, in a unanimous decision written by Justice Chin. Justice Chin noted that Sinclair did not allege that the fees exceeded the cost of the program called for by the Act or that the fees bore "no reasonable relationship to the social or economic 'burdens' that Sinclair's operations generated."[8]

Unlike the Court of Appeal, the Supreme Court concluded that the Act did impose "bona fide regulatory fees" because "it requires manufacturers and other persons whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating adverse health effect their products created in the community."[9] The Court stated, "viewed as a 'mitigating effects' measure, it is comparable in character to similar government power measures imposing fees to defray the actual or anticipated adverse effects of various business operations."[10] In the court's view, the case law it reviewed "clearly indicates that the police power is broad enough to include mandatory remedial measures to mitigate the past, present, or future adverse impact of the fee payer's operations, at least where, as here, the measure requires a causal connection or nexus between the product and its adverse effect."[11]

The Court also stated: "The fact that the challenged fees were charged after, rather than before, the product's adverse effects were realized is immaterial to the question whether the measure imposes valid regulatory fees rather than taxes."[12]

Thus, under *Sinclair Paint*, an imposition is a valid regulatory fee, and not a tax, provided that it: (1) mitigates the actual or anticipated adverse effects of the fee payer's activities; (2) bears a reasonable relation to those adverse effects; (3) is not imposed for unrelated revenue purposes; and (4) does not exceed the reasonable cost of providing the service or regulatory activity for which it is charged.

Proposition 37 states that *Sinclair Paint* "defined a fee in such a manner as to unreasonably broaden the purposes for which fees can be imposed" and "will encourage the use of fees to avoid the vote requirements of Articles XIII Axiii and XIII C[14] and significantly weaken the tax provisions created by these propositions."[15] Accordingly, in the view of Proposition 37's framers, the measure would "preserve that distinction [between a fee and a tax] and prevent avoidance of the two-thirds legislative vote requirement of Article XIII A and the majority and two-thirds popular vote requirements of Article XIII C."[16]

The Basic Rule of Proposition 37

The essential rule of Prop. 37 is that "compulsory," post-July 1, 1999 fees which:

> "are imposed to monitor, study or mitigate the society or economic effects of an activity;" and,
>
> "impose no significant regulatory obligation on the fee payor's activity other than the payment of the fee,"

are taxes that require super-majority legislative approval or voter approval. It also restates Proposition 13's existing rule that a fee that generates more revenue than necessary to fund the service or regulatory program for which it is imposed is a special tax.

The Exceptions

To this stated rule, there are numerous, express exemptions:

- Assessments, governed by Proposition 218;[17]
- Property related fees governed by Proposition 218;[18]
- Real property development fees;[19]
- Regulatory fees that do not exceed the reasonable cost of regulating the activity for which the fee is charged; and,
- Damages, remedial expenses, or penalties arising from a specific event.

What Fees Will Be Affected by the Measure?

Although the campaign with respect to Proposition 37 has barely begun, there is already substantial disagreement as to its effect. One useful way to understand the scope of the proposal is to identify the fees that it is understood would become taxes under this measure, those which are understood to be excluded from the new rule, and those as to which these is some doubt.

The fees that seem relatively certain to be recast as taxes by the measure include:

- Fees imposed under the Childhood Lead Poisoning Prevent Act of 1991, upheld in *Sinclair Paint*. "grandfathering" language, but a substantially similar fee imposed after Proposition 37's adoption would be invalid.
- Fees imposed on property owners to fund litter abatement programs.[20]
- Fees imposed on cigarettes to fund programs to mitigate the health effects of smoking.[21]
- Fees imposed on oil producers to fund oil spill prevention programs.[22]
- Recycling fees to pay for tire and motor oil disposal.[23]
- Fees on railroads to fund emergency responses to hazardous material spills.[24]
- Fees on purveyors of "fast food" to fund litter abatement efforts.[25]
- Fees on foods to fund health programs.
- Fees on fossil fuels to discourage their consumption and to fund alternative energy and energy conservation programs.
- Fees on electric utilities to fund efforts to study the health effects of exposure to electromagnetic field (EMF) radiation.
- Fees on household products to fund poison control centers.

The conclusion that these fees will become taxes upon the approval of Proposition 37 reflects the assumption that they are not associated with regulatory programs which "impose significant regulatory obligations on the fee payor's activity other than the payment of the fee" itself. This fact underlies many of the differences between the proponents and opponents of the measure, discussed below.

There is also agreement as to a range of fees that would be unaffected by the measure. These include:

- Fees on liquor stores to enforce regulations designed to prevent public nuisances.[26]
- Fees on residential landlords to fund enforcement of housing regulations, including slum abatement efforts.[27]
- Fees on drunk drivers to fund the cost of responding to emergencies created by their conduct.[28]
- Real property development fees.[29]
- School development fees.[30]

Again, the conclusion that these fees are exempt from Proposition 37 turns on the assumption that they are imposed in conjunction with a significant regulatory program.

However, there is substantial uncertainty as to how Proposition 37 would affect other fees. These fees are discussed below.

A. Assessments Imposed Under the Parking and Business Improvement Area Law of 1989.

Business Improvement District (BID) assessments on real property imposed under the Property and Business Improvement District Law of 1994[31] are imposed on property and constitute assessments subject to Proposition 218.[32] By contrast, 1989 Act BID assessments are imposed on businesses without respect to land tenure and are typically collected as surcharges on business license taxes. 1989 Act BID assessments were upheld against assertions that they constitute "special taxes" in *Evans v. City of San Jose*[33] and, because they are not imposed "on property," are exempt from Proposition 218.[34] Accordingly, Proposition 37's exclusion of assessments and fees "as defined in Article XIII D, sections 2(b) and (2e)" does not protect 1989 Act BID assessments.

The proponents of Proposition 37 state that the fees not subject to Proposition 37's new rules include "fees that finance services that provide a benefit to fee-payer" including fees imposed by Business improvement districts. Business improvement districts provide a specific benefit to the businesses that pay the assessment. Therefore this is not a fee covered by Proposition 37."[35] Thus, the proponents of Proposition 37 characterize 1989 Act BID assessments as service fees. There is language in the *Evans* decision that can be read to support that characterization.[36] Accordingly, it is an open question whether the courts would interpret Proposition 37 to convert 1989 Act BID assessments into taxes requiring two-thirds voter approval. It is fair to say, however, that approval of Proposition 37 would raise a significant question about the continued validity of 1989 Act BID assessments.

B. Fees Associated with Regulatory Programs.

Proposition 37 treats as taxes only those regulatory fees "which impose no significant regulatory obligation on the fee payor's activities other than the payment of the fee." This test will obviously require judicial construction, as the term "significant" is imprecise. The proponents and opponents of the measure disagree most fundamentally on these fees, with the proponents asserting, for obvious reasons, that Proposition 37 will catch in its net a broad range of popular fees, and the opponents, for equally obvious reasons, denying the claim. Among the fees the contestants have argued about are: landfill closure fees, fees imposed pursuant to the California Environmental Quality Act (CEQA)[37] for the mitigation of the social and economic impacts of a project, oil spill prevention fees, lead paint clean-up fees, airport noise abatement fees, fees imposed to monitor or to remediate pollution and other nuisances, a fee on MBTE to fund groundwater clean-up, and pollution permit fees.[38]

Given the language of the measure, and the nature of the fee in issue in Sinclair Paint, I conclude that Proposition 37 exempts fees associated with regulatory programs that require regulated entities to conform their conduct to rules adopted for the public benefit. It may be more difficult to protect from Proposition 37 fees on regulated businesses that are not directly tied to a regulatory program, but have practical relationship to those programs, such as the fee on sign permittees to fund an inventory of legal and illegal signs upheld in *United Business Com. v. City of San Diego*.[39]

C. Trench Cut Fees.

The proponents of Proposition 37 assert that the measure would convert to taxes "fees to mitigate potential damage to existing infrastructure" and "fees to pay for the diminution in durability and longevity of roads due to road cuts necessary for cable installation."[40] The proponents offer no rationale for this conclusion, but may be implicitly arguing that a fee imposed on a utility that cuts a street to lay new facilities, and that also repaves the resulting cut in the street, necessarily exceeds the cost to the local government associated with the utility's activity. That argument, of course, arises under the existing rules of Proposition 13 regarding the distinction between fees and special taxes. If local governments can carry their burden to provide the cost justification for such fees, such fees should withstand attack under Proposition 37. It is not credible, to this author, at least, to claim that trench cut fees are not imposed in connection with a substantial regulatory program. It may be advisable, however, to adopt such fees as an amendment to the local highway permit ordinance so that the relation of the fee to a substantial regulatory program is obvious.

D. Fees on Cellular Phones to Fund 911 Services.

The proponents argue that "fees on cell phones to subsidize the state's 911 service" would become taxes if Proposition 37 is approved.[41] Again, no rationale for this claim is offered. However, it would seem that such fees provide as much benefit to cell phone users as BID assessments provide to businesses. As discussed above, the proponents claim that BID assessments will not be impaired by Proposition 37 because they benefit the assessed businesses.[42] This contrast suggests that the proponents' arguments have more political appeal than consistent logic. In any event, a strong argument can be made that a fee on cell phones to fund 911 services are not "compulsory fees enacted after July 1, 1999 to monitor, study or mitigate the societal or economic effects of an activity" but rather elective, service fees and thus fall outside Proposition 37's terms.

E. Development Impact Fees.

Proposition 37 expressly exempts "real property development fees," but does not define the term. The usual definition of that term includes fees imposed on those who develop real property to offset the impacts of the development.[43] The proponents of the measure explain this exclusion this way: "Fees specifically excluded by Proposition 37 [include] [f]ees on developers to pay for infrastructure and to mitigate growth impacts. Specifically excluded under Section 3 of Proposition 37."[44] Somehow, the proponents ignore the force of their own argument, however, in claiming that certain development impact fees would become taxes under Proposition 37. These include: "Traffic impact fees on arenas, theatres, amusement parks, entertainment centers," "[p]ublic safety impact fees," and "[l]ocation mitigation fees relating to traffic, clean-up, public safety and emergency services."[45] Again, no rationale for these assertions is given. If the point is that fees imposed on pre-existing businesses outside the land use entitlement process are effectively taxes, Proposition 37 apparently would have that effect. If the point is that the exclusion for "real property development fees" includes some, but not all, fees imposed in the land use entitlement process to offset development impacts, then the proponents are off the mark. Proposition 37's exclusion of real property development fees is not so limited.

F. Parking Fees.

Proposition 37 governs "compulsory fees enacted after July 1, 1999 to monitor, study or mitigate the societal or economic effects of an activity." Services fees imposed on those who voluntarily consume a government service, and fees in the nature of rental charges for the use of public property, would not seem to fall within this phrase. Parking meter charges would seem to be in the nature of rent for the use of public property and not subject to any limitation except "what the market will bear." The opponents of Proposition 37 raise an issue on this point, however:

> "Local government is still analyzing the measure, particularly with the types of fees they enact. In addition to being able to clean up existing pollution, they have expressed concern that differential fees used to discourage an activity by setting fees on some activities higher than another option will be considered unconstitutional (e.g., different parking rates to relieve congestion at a location)."

A similar issue was presented to the Attorney General with respect to the impact of Proposition 218's fee provisions on tiered water rates, which encourage conservation by making water progressively more expensive as more is consumed. The Attorney General concluded that Proposition 218 does not affect tiered water rates because metered water rates are imposed on the voluntary decision to consume water and are not compulsory fees on property or on a person as a consequence of property ownership.[46]

Similarly, a strong argument can be made that elective service fees and fees in the nature of rent for the use of public property, including parking fees, are exempt from both Proposition 37 and Proposition 218 because these are neither "compulsory fees" nor "fees on a parcel or on a person as an incident of property ownership,"[47] the operative terms of the two measures, respectively.

Conclusion

There was a time when the phrase "public finance attorney" was synonymous with bond lawyer, as only the debt side of local finance had sufficient legal complexity to require a specialty practice. The voters of California, however, have created the need for a new specialty, "municipal revenue attorney" perhaps, to cope with the complexity created by Proposition 13, the Gann Limit, Proposition 62, and Proposition 218. This fall, Proposition 37 may join this list. If so, that measure is just as likely to require judicial interpretation as have its predecessors. In any event, the measure does not promise to make the revenue side of government finance less complex.

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Endnotes

1 California Constitution, Article XIII A, Section 3. All references in this article to "Articles" and "Sections" are to the California Constitution unless otherwise expressed.

2 Article XIII C, Sections 2(b) and (d).

3 Section 3 of Proposition 37.

4 Section 4 of Proposition 37 amends Section 1(e) of Article XIII C in the manner outlined above, except that the phrase "state taxes" in the first line quoted above is replaced with "'general taxes' and 'special taxes.'"

5 15 Cal.4th 866 (1997).

6 Health and Safety Code Sections 105275 et seq.

7 Id., Section 105310(d).

8 15 Cal.4th at 876.

9 Id. at 877.

10 Id.

11 Id. at 877-78 (emphasis original).

12 Id. at 879.

13 I.e., Proposition 13.

14 I.e., Proposition 218.

15 Proposition 37, Section 2(e) and (f).

16 Id., Section 2(h).

17 Article XIII D, Section 2(b) states Proposition 218's definition of "assessments".

18 The peculiar definition of "property related fees" subject to Proposition 218 is stated in Article XIII D, Section 2(e) and is in issue in *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*, Case No. S082645, which is fully briefed and awaiting oral argument in the California Supreme Court. See note 27 below.

19 No definition of this term is provided, but the definition in 1987's A.B. 1600, Government Code Sections 66000(b), would appear to be the logical place to start in constructing such a definition.

20 Such fees are authorized by Government Code Section 25830 and were upheld in *Kern County Farm Bureau v. County of Kern*, 19 Cal.App.4th 1416 (1993). In Opinion Number 7359, issued to Senator Byron Sher (D-Palo Alto) on April 28, 1997, the Legislative Counsel characterized these fees as property related fees within the sweep of Proposition 218.

21 This example is cited in the Legislative Analyst's Impartial Summary of Proposition 37, which will appear in the Voter Information Pamphlet, which is available on-line at www.lao.ca.gov/initiatives/2000/37_11_2000.html. The opponents of the measure make the same observation at http://nextgeneration.org/polluterprotection/fact/htm.

22 The proponents observe that the fees that fund the existing Oil Spill Prevention Fund were enacted in 1990 and thus are "grandfathered" by Proposition 37. www.yesonprop37.org/notcovered.html.

23 The proponents note that the existing tire and oil recycling fees were adopted by a greater than a two thirds margin in the Legislature and thus would have been validly approved even if Proposition 37's rules had been in effect when those fees were imposed. Id.

24 The proponents note that the fees that fund the existing Emergency Railroad Response Trust Fund are grandfathered, as well. Id. These fees were imposed following an rail accident in Dunsmuir, California that caused substantial environmental damage when toxic chemicals were spilled into a river adjacent to the tracks. http://nextgeneration.org/polluterprotection/fact/htm.

25 The proponents of the measure give this example and the four that follow. www.yesonprop37.org/covered.html.

26 Such fees were upheld in *City of Oakland v. Superior Court*, 45 Cal.App.4th 740 (1996). The proponents and opponents of Proposition 37 disagree as to the measure's impact on such fees. The opponents list such fees as among those endangered by Proposition 37. http://nextgeneration.org/polluterprotection/fact/htm. The proponents respond that Proposition 37 will not affect "fees to regulate specific activities or recover specific costs" including "[f]ees on liquor stores to mitigate public safety problems. If the fee is on stores in specific problem areas, and the fees go to pay for additional police protection in those areas, Proposition 37 would not apply." www.yesonprop37.org/notcovered.html. The proponents suggest that Oakland's liquor store fees are either regulatory fees or fees which recover the cost of a service. Given that Oakland imposes a substantial regulatory program on liquor stores, the former argument would seem to be the stronger.

27 An attack on Los Angeles' fee of this type is pending in the California Supreme Court in *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*, Case No. S082645. The Second District Court of Appeal had concluded that this fee was a property related fee subject to fee-payer approval under Proposition 218's Article XIII D, Section 6(a) and (c). The City contends the fee is exempt from Proposition 218 as a fee on a business in which fee payers voluntarily participate rather than a compulsory fee on property or property owners per se. Given that such fees are imposed in the context of a substantial regulatory regime, I view such fees as exempt from Proposition 37. The opponents of Proposition 37 dispute this point. http://nextgeneration.org/polluterprotection/fact/htm.

28 The opponents dispute this conclusion. Id. The proponents argue the measure does not extend to "Fees to regulate specific activities or recover specific costs" including "[f]ees charged to persons convicted of driving under the influence to help offset the cost of emergency medical services. Not defined as a tax under Proposition 37." www.yesonprop37.org/notcovered.html. My conclusion that such fees are exempt from Proposition 37 relies on the measure's express exemption for "[m]onies recoverable as damages, remedial expenses or penalties arising from a specific event." (Emphasis added.)

29 See Section 3 of Proposition 37.

30 The proponents were sufficiently concerned by the Legislative Analyst's tentative conclusion that the measure might endanger school impact fees that they threatened suit if that conclusion were included in the Impartial Analysis of the measure. July 7, 2000 letter from Richard D. Martland of Nielsen,

Continued on page 15

Has the Future of Mandates Arrived? *County of Sonoma v. California Department of Finance*

By Mark Cornelius, Esq.*

Pending at the time of the writing of this article, in the First Appellate District of the California Court of Appeal, is a matter concerning the shift of property taxes from local public entities to the schools, which began in 1992. *County of Sonoma v. California Department of Finance* has the potential to settle the long-simmering dispute between local public entities and the State of California concerning the referenced property tax shift, and could alter the way that practitioners look at state mandates.

The Commission on State Mandates Proceeding

The County of Sonoma and 47 other California counties filed a test claim with the Commission on State Mandates (Commission), complaining of a property tax shift from local governments to educational revenue augmentation funds (ERAFs) in fiscal years 1996-97 and 1997-98.[1] The Commission framed its consideration of the issues in two questions: (1) whether the reallocation of property tax revenues from counties to ERAFs for distribution to schools and community college districts is subject to Article XIIIB, Section 6 of the California Constitution; and (2) whether the reallocation of property tax revenues from counties to ERAFs constitutes a reimbursable state mandated program under the referenced Constitutional section and under section 17514 of the California Government Code. The Commission never reached consideration of the second question, because it answered the first question in the negative.

The Commission adopted its Statement of Decision on November 30, 1998. The Commission noted that the claimant counties estimated that during fiscal years 1996-97 and 1997-98 they paid 4.5 billion dollars into ERAFs. The Commission found that the test claim legislation required county auditors to reduce property tax revenues previously allocated to counties, deposit the reduced revenues in the ERAFs, and then allocate the revenues to schools.[2] The Commission further found that reimbursement under Article XIIIB, Section 6 is designed to protect proceeds of taxes of local agencies from state mandated programs that require the expenditure of their tax proceeds when the local agencies are subject to a spending cap. The Commission recognized that the counties and other local entities subject to the test claim legislation never receive the property tax revenues that are reduced by the county auditors, but that the auditors reduce the property tax revenues before allocation. The county auditors then transfer the revenues into the ERAFs for the support of the schools. The Commission found therefore that there was not a local expenditure within the meaning of Article XIIIB, Section 6. Based upon this finding, the Commission concluded that the reduction of property tax revenue previously allocated to counties for the distribution to schools is not subject to the referenced Constitutional section. The Commission reached its decision on a 5-2 vote.[3]

Sonoma County Superior Court Proceeding

On March 17, 1999, the County of Sonoma filed a petition for writ of mandate with the Sonoma County Superior Court, asking the Court to set aside the referenced decision of the Commission.[4] The Court granted leave for an additional fifty-five counties to intervene in the proceeding.

In his Statement of Decision, Judge Sawyer noted that Article XVI, Section 8 of the California Constitution[5] provides that the State must set apart monies from its revenues for the support of the public school system. He stated that the issue in the case before him was not whether the State had the authority to allocate property taxes to schools, but whether the State can use the property taxes to fulfill its obligations to provide funds for the schools from the State General Fund. He noted that counties are not required to expend their own funds on new programs in order to be entitled to reimbursement, and that it is sufficient if the responsibility to fund the cost of a program is shifted from the State to the counties. He further observed that the triggering event for required reimbursement is not the expenditure of money by the counties, but the transfer of financial responsibility for the costs of a program from the State to the counties.

Judge Sawyer concluded that the ERAF legislation had created a new program or higher level of service which required reimbursement under Article XIIIB, Section 6 of the California Constitution. He further concluded that the shift of local property taxes compelled the counties to accept financial responsibility in whole or in part for a program which was required to be funded by the State by the enactment of Proposition 98. He noted that there is no requirement that an actual expenditure of tax proceeds be made before a local government is entitled to reimbursement.

The Appellate Proceedings

The State of California, Department of Finance and Director of Finance appealed the decision of the Superior Court. The matter has now been fully briefed, and at the time of the writing of this article, awaits oral argument. As one may extrapolate from the gist of the ruling of the Superior Court, the counties had placed emphasis upon their view of the state's responsibilities for funding public education. The opening brief of the counties continues iterating that view, and presents a history of educational funding in California as related to restraints on taxing power.

The Counties' Position

The counties assert that Article IX, Section 5 of the California Constitution required the state legislature to provide for a single statewide system of free common schools, and that Article IX, Section 6 established a state school fund for the support of the schools. School funding has emanated for many years from two primary sources: the amount of local property taxes that each school district determined to be necessary, authorized by the Legislature pursuant to Article XIII, Section 21 of the Constitution, and from the referenced state school fund.

In 1976, the Supreme Court of California decision in *Serrano v. Priest* determined that public school financing was unconstitutional because of too much reliance on local property taxes as revenue for schools, resulting in a failure to achieve equalized funds. In other words, poorer districts were disadvantaged because of the claimed over reliance on property taxes.[6] In the wake of the *Serrano v. Priest* decision, the voters of California in 1978 adopted Proposition 13, adding Article XIIIA to the California Constitution. This measure limited the property tax rate to one percent and provided that the tax would be allocated according to law to the districts within the counties.

The State reacted to the enactment of Proposition 13 with legislation designed to bail out the local governments from what was perceived to be the otherwise potentially disastrous effects of the limitation on property taxes. Legislation in 1978-79 allocated property tax revenue to each local government in proportion to the pre-Proposition 13 shares.[7] The following year the State adopted what is commonly known as AB 8,[8] where the State shifted a greater share of property taxes to non-school entities. The counties assert that adoption of AB 8 not only helped to relieve local entities from the problems caused by Proposition 13, but also brought the State into compliance with *Serrano v. Priest,* which required equalized school funding.

In November 1979, the voters of California struck again, this time adopting Proposition 4, which added Article XIIIB to the California Constitution. The initiative limited spending by state and local governments and added Article XIIIB, Section 6, the mandate provisions which are the centerpiece of the *County of Sonoma* litigation. The counties assert that Section 6 prevents the State from returning to local entities fiscal responsibilities that the State assumed through the adoption of AB 8 before the adoption of Proposition 4.

In 1988, the voters adopted an initiative centrally relevant to educational funding, namely Proposition 98, which added Article XVI, Section 8 to the California Constitution. Proposition 98, and as later amended, provided that schools would have minimum funding as set forth in three tests. The counties largely focused upon the first test, asserting that the State's contribution to schools would be no less than the percentage of state general fund revenues appropriated to schools in fiscal year 1986-87.

In 1992, the State was experiencing a well-publicized potential budget shortfall. The Legislature adopted what is now Revenue and Taxation Code section 97.2, where county auditors were directed to reduce the allocation of property taxes that non-school local government entities would have received under AB 8 and place the reduction into ERAFs. The money from ERAFs was then distributed to school districts to the amount of the revenue limit established for each district pursuant to Education Code Section 42238. The counties assert that this mechanism reduced the State's potential obligation for school funding from the general fund from 40.33% of the fund in 1986-87 to 34% in 1993-94.

The counties argue that the minimum general fund contributions to school funding provided in Proposition 98 would have prevented the State from saving general fund money through the funding of public schools via the ERAFs, but for the adoption of Education Code section 41204.5. That section provided that the tax shift accomplished through the ERAF legislation was deemed to have occurred in 1986-87, not 1992-93, resulting in a lower percentage of state general fund money being committed to the funding of public education pursuant to Proposition 98.

The counties have asserted throughout the litigation that the ERAF legislation resulted in the shift of responsibility for at least a portion of a state program to counties and other local governments, requiring reimbursement under the provisions of Article XIIIB, Section 6 of the Constitution. That section provides in relevant part:

Whenever the Legislature or any State agency mandates a new program or higher level of service on any local government, the State shall provide a subvention of funds to reimburse such local government for the costs of such program or increased level of service. . .

An initial reading of the above section raises the question of whether the funding of schools through local property taxes can be considered to be a new program. The counties rely in part on the case *Lucia Mar Unified School District v. Honig*[9] for the proposition that the creation of a new program is not necessary in order to trigger the requirement of reimbursement. In that case, the Supreme Court determined that legislation shifting partial financial responsibility for the support of students in state-operated schools from the state to school districts called for the school districts to support a new program.

The counties also point to *County of San Diego v. State of California*[10] for the premise that is not necessary for legislation to require that local entities do or spend anything in order to receive state reimbursement under Section 6. In that case, the Supreme Court noted that the Legislature made exclusions from Medi-Cal, knowing and intending that the legislation would result in the counties being responsible for the excluded medical care, since counties were statutorily designated as providers of last resort. Thus, the Court concluded that the legislation at issue mandated a new program on counties, by compelling them to accept financial responsibility in whole or in part for a program which was funded entirely by the State before the advent of Article XIIIB of the Constitution.

The counties' central assertion is that the fundamental issue should be whether there has been a shift in financial responsibility from the state to the local level, not whether there have been actual local expenditures.

The State's Position

The State of California, Department of Finance and Director of Finance (state litigants) raise many points throughout the litigation, and specifically in the appellate briefs, which must be addressed and overcome in order to sustain the counties' claims for reimbursement. The state litigants assert that the counties are not entitled to any fixed share of property taxes, and that the state is entitled to apportion property taxes.[11] They further note that the ERAF legislation under examination has already survived successful attack in two published cases, *County of Los Angeles v. Sasaki* and *San Miguel Consolidated Fire Protection District v. Davis*.[12] They note that any claim that the counties are making for reimbursement must necessarily be premised upon the idea that the counties are entitled to the property tax revenue in question, and that the referenced cases have already defeated such a premise.

The state litigants observe that former Revenue and Taxation Code section 97.03[13] effected the reallocation of property taxes in question as part of the 1992-93 Budget Act. They state that the effect of the reallocation was to restore the revenue distribution ratio to roughly the same level that existed in 1977-78, just before the passage of Proposition 13. They note that this was merely a distribution of revenue. The legislation did not direct the counties to spend their portion of the revenue in any specific manner, nor to implement, oversee or administer any new program. They also note that an essential part of allocation of property tax revenues is the determination of what is the fairest and most effective apportionment of the money, which is a political question for the Legislature, not a matter for judicial construction. They assert that through the challenged ERAF legislation, the State was simply altering the share of revenue appropriated to traditional and constitutional recipients, namely, counties, cities, schools and other local districts. They argue that the gradual reduction in revenue experienced by the counties over the years cannot be attributed to any gain or encroachment by the school districts, but is reflected in the growth of other districts, namely new special districts and redevelopment agencies, which assumed responsibility for many of the services formerly provided by the counties. The state litigants further argue that reimbursement is not required when there is downward fluctuation in the counties' revenue, and that reimbursement should not be extended to encompass the State's rightful reallocation of tax revenues, to which the counties had no specific entitlement.

The state litigants question whether a reimbursable state mandated new program or service can be found when the ERAF legislation did not require the counties to expend money from their proceeds of taxes, nor to administer any program or service. They argue that Article XIIIB, Section 6 addresses only local expenditures, and is not a guarantee of a revenue stream. They cite the County of San Diego case relied upon by the counties to support the state litigants' position that local governments seeking reimbursement must first demonstrate that the state legislation at issue required them to expend their proceeds of taxes to implement a new program or higher level of service, and that reimbursement is not required to backfill reduced revenues.

As to the counties' reliance upon their interpretation of the State's responsibilities for school funding under Proposition 98, the state litigants argue that since the counties are not school entities they have no standing to raise the issue. They further observe that the court in *Sasaki* already determined that the litigant county there had no such standing. The state litigants further note that even if the counties' Proposition 98 argument were resolved to impose upon the State the level of school funding from the general fund as asserted by the counties, the counties would not thereby be entitled to additional property tax revenue.

The Future of Mandates

As the counties state in their appellate brief, the final decision reached by the Court of Appeal will be binding on the state and will affect all counties, cities and special districts in California. It is interesting to contemplate and speculate upon what will be the future of mandate proceedings and of property tax allocation decisions after the Court reaches its decision. Amicus Commission asserts in its appellate brief that if the relief the counties are seeking is granted, every change in funding will be the basis of a possible reimbursement claim. In such claims the Commission would be required to consider such far-reaching issues as offsetting revenue sources, relief from other state mandated programs and other state actions that would affect revenue and expenses of the claimant. This is arguably the only way that a reimbursable cost resulting from a revenue change can be measured.

Pertinent to the case at issue here, the Commission notes that the state has control over not only property tax, but also other county revenue sources. The Commission asserts that the state has provided relief to the counties from the property tax shift via these revenue sources, namely, the Proposition 172 sales tax, trial court funding relief, the Citizens Option for Public Safety program, general assistance, and other programs. The Commission argues that if relief is granted in this and other future mandate cases, it would be necessary for the Commission to consider such offsetting revenues, as well as cost savings resulting from relief from previously imposed obligations. The Commission asserts these and similar considerations are appropriately debated as policy issues by the legislature, rather than being subject to decision by an administrative body created to alleviate unnecessary litigation and reimbursement delays.

On the other hand, what will be the future of property tax allocation if the relief sought by the counties is not granted? The counties acknowledge the partial mitigation to the property tax shift resulting from such measures as the Proposition 172 sales tax. The counties protest, however, that these and other claimed mitigation monies are not discretionary, but that they are earmarked for a particular purpose. The counties assert that an adverse ruling in this case could result in a circumstance where arguably all of the counties' discretionary funds could be replaced with earmarked funds. The counties have discussed even more severe scenarios than this, such as where additional funds are shifted for other purposes than schools, i.e., for highways.

Speculation concerning future results from the decision on the Sonoma County case could proceed at length. Suffice it to say that all levels of government and their legal practitioners are interested, to say the least, in the outcome.

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Endnotes

1 The test claim was brought under Revenue and Taxation Code, Sections 95, et seq., 95.1, et seq., 97.01, et seq., 97.03, 97.035, et seq., 97.038, Education Code, Section 41204.5, and other statutes.

2 The Commission noted that the relevant portions of the test claim legislation are found in Revenue and Taxation Code, Section 97.03 and Education Code, Section 41204.5.

3 The Commission is a seven-member board consisting of the Director of the Department of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, and three appointees of the Governor, consisting of a public member experienced in public finance and two representatives of local government and/or schools. This composition is set forth in Government Code Section 17525.

4 The writ of mandate proceeding was brought pursuant to Code of Civil Procedure, section 1094.5, under the authority of Government Code, Section 17559.

5 The voters of the State adopted Proposition 98 on November 8, 1988, which added Article XVI, section 8 to the California Constitution.

6 *Serrano v. Priest* (1976) 18 Cal. 3d. 728.

7 Stats. 1978, c.292.

8 Revenue and Taxation Code, Section 95, et seq. contains the tax allocation provisions.

9 *Lucia Mar Unified School District v. Honig* (1988) 44 Cal 3d. 830.

10 *County of San Diego v. State of California*

(1997) 15 Cal. 4th 68.

11 The state litigants cite *Amador Valley Joint Union High School District v. State Board of Equalization* (1978) 22 Cal. 3rd 208, *Sasaki* and *San Miguel* for this proposition.

12 *County of Los Angeles v. Sasaki* (1994) 23 Cal. App. 4th 1442; *San Miguel Consolidated Fire Protection District v. Davis* (1994) 25 Cal. App. 4th 134.

13 Now Revenue and Taxation Code section 97.2.

14 *California Teachers Association v. Hayes* (1992) 5 Cal. App. 4th 1513.

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Merksamer, Parrinello, Mueller & Naylor to Marianne O'Malley, Principal Fiscal & Policy Analyst, Legislative Analyst's Office. This letter may provide convincing "legislative history" with respect to the breadth of Proposition 37's exclusion of "real property development fees."

31 Streets & Highways Code Sections 36600 et seq.

32 Article XIII D, Section 2(b).

33 3 Cal.App.4th 728 (1992).

34 *Howard Jarvis Taxpayers Ass'n v. City of San Diego*, 72 Cal.App.4th 230 (1999).

35 See: www.yesonprop37.org/notcovered.html.

36 3 Cal.App.4th at 738-39.

37 Public Resources Code Sections 21000 et seq.

38 Compare the opponents' discussion at http://nextgeneration.org/polluterprotection/fact/htm with the proponents' rebuttal at www.yesonprop37.org/notcovered.html.

39 91 Cal.App.3d 156 (1979).

40 See www.yesonprop37.org/covered.html.

41 Id.

42 See: www.yesonprop37.org/notcovered.html.

43 E.g., Government Code Section 66000(b) (fees imposed on development to fund "public facilities related to the development project").

44 See: www.yesonprop37.org/notcovered.html.

45 See www.yesonprop37.org/covered.html.

46 80 Ops. Calif. Att'y Gen'l 183, 186 (1997).

47 Article XIII D, Section 2(e).

A Message From The Chair

By Henry D. Nanjo

"Konichiwa, Hajimemashite"!

Roughly translated, that means, "Hello, nice to meet you for the first time." This phrase struck me as best stating my sentiments as I draft my first message as chair. By way of introduction, I am a fourth-generation Japanese American, and a deputy county counsel for the County of Sacramento. I have been with the County of Sacramento for the last 4 years representing the County's Department of Airports. Prior to that I, was a litigator in private practice, specializing in Automotive Lemon Law, Automotive Dealership defense, Product's Liability, and some Land Use matters. I have been with the public law section since joining the County of Sacramento, to expose me to all your expertise, which is, and has been reflected in our Public Law Journal. I hope to meet as many of you, personally, as possible at events throughout the state. I invite you to contact me any time either by telephone at (916) 874-5567 or by e-mail at nanjohd@sac.ca.gov.

Here we are, about to close the year 2000. I am reminded of the saying, "In like a lion, out like a lamb". At the close of last year, Public Law attorneys and their clients were warned about the "Y2K Bug", the potential threat from those fearing the end of the world and many other ancillary issues to those significant issues which face public lawyers. Fortunately, the year 2000 has not caused nearly the catastrophes or had the effect that some feared it would. In fact, for the most part, other than the normal, run-of-the-mill disasters, the year 2000 has not been that significant. Or has it?

At the State Bar of California, the Bar continues to restructure itself. The Bar continues to require the sections to be self-sufficient and pay for it's "fair share" of administrative overhead and other services. This has resulted in the need for the sections to find ways to "do more, with less" or at least try to do the same amount. This has resulted in the unfortunate need to raise section dues last year and requires the Executive Committee to find more efficient ways to work. The overhead costs that our section has been assessed are more easily absorbed with more members. Thus, if any of you can share your Public Law Journal with colleagues and encourage them to join the section we will all benefit.

For public entities, issues arising from the new census will likely occur in 2001. Redistricting will likely have an effect in some way the practice of all public lawyers. In addition, with the current economic growth, proceeds from tobacco litigation settlement, election year politics and issues of development vs. conservation, the challenges for public lawyers will continue in 2001.

Remember that this is YOUR Public Law Section. I invite and challenge you to contact me to let me know what you like or don't like about the section, Public Law Journal, or the activities of the section. What are the activities of the section, you ask? Well go to the Public Law Section's web site at www.calbar.org/publiclaw, and click on the link to the Member's only area. Use your State Bar number as your user ID and password, then immediately change your password! This will give you access to the "MEMBER'S ONLY" Section! I want to modify my comment, above, if you are going to send information on what you don't like, send us a constructive way we can improve!

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